

Distribution Contracts Oversight Scheme: Comments on the Assessment of the Firstgas Use-of-System Agreement

1.1 Purpose

This paper accompanies the independent assessor's report assessing the alignment of the Firstgas Use-of-System Agreement (the Agreement) with the Gas Distribution Contracts Oversight Scheme.¹

This paper provides Gas Industry Co's comments on matters that the independent assessor raised for Gas Industry Co to consider in section 4.4 of the independent assessor's report.

1.2 Background

The Gas Distribution Contracts Oversight Scheme (the Scheme) is a voluntary, industry-agreed scheme that assesses standard gas use-of-system agreements against a set of principles for these agreements (the Principles). The Scheme was endorsed by the Minister of Energy and Resources in September 2012 and aims to ensure that the core terms and conditions in use-of-system agreements are clear and reasonable; promote market efficiency; and ultimately enhance consumer outcomes. The Scheme does not assess negotiated use-of-system agreements.

The assessment of new use-of-system agreements is completed by an independent assessor to provide gas industry participants with a level of assurance of objectivity in the assessment process.

The Scheme focuses the assessment on areas of particular concern for industry, recognising that it is impractical to assess the alignment of every clause in a use-of-system agreement with the Principles.

Assessments were completed in 2013 and 2014. The 2014 assessment concluded that the Vector, Powerco and Gasnet use-of-system agreements were substantially aligned with the Principles. Firstgas inherited Vector's use-of-system agreement when it acquired the Vector gas distribution networks outside of Auckland in 2016.

Information about the Scheme and previous assessments can be found [here](#).

¹ Assessment Report: Assessment of First Gas Limited 2023 Use of System Agreement against Gas Distribution Contracts Oversight Scheme

Firstgas recently completed a process to develop a new use-of-system agreement in consultation with retailers connected to its distribution network. The Agreement is available [here](#).

Gas Industry Co has committed to reviewing revised or replacement use-of-system agreements.

1.3 Assessment approach

Gas Industry Co appointed Brigid McArthur of Greenwood Roche to undertake the role of independent assessor to assess the Agreement.

The assessment approach aligns with the Scheme as recommended to, and endorsed by, the Minister of Energy and Resources in September 2012.

The assessment approach included the following process steps:

	Description of step
1.	Gas Industry Co contacts retailers to advise of assessment and requests a point of contact for each retailer.
2.	Independent assessor invites retailer feedback on alignment of the Agreement with the principles.
3.	Firstgas is provided with an opportunity to respond to alignment issues identified by retailers.
4.	Draft assessment completed and draft assessment results provided to Firstgas and Gas Industry Co.
5.	Firstgas and Gas Industry Co respond to draft assessment.
6.	Assessment finalised. Report completed.
7.	Final assessment issued to Firstgas and Gas Industry Co. Consolidated report published by Gas Industry Co.

The Scheme requires the independent assessor to assess the alignment of the Agreement with the Principles in accordance with the following levels of alignment:

Level of alignment	Description
Full	Meets the intention of the principle in all respects.
Substantial	Meets the intention of the principle in most respects. Only minor changes are needed to meet 'full' ranking.
Moderate	Meets the intention of the principle in some respects. More substantive changes are needed to improve the ranking.
Low	Little alignment with the intention of the principle and substantial changes are needed to improve the ranking
Nil	No alignment with the intention of the principle.

1.4 Assessment outcomes

1.4.1 Overall alignment

Overall, the Agreement achieves "Substantial" alignment with the Principles. The independent assessor describes the Agreement as meeting the intention of the Principles in most respects, with only minor amendments being required to achieve "Full" alignment. The independent assessor noted that the overall assessment of "Substantial" alignment reflected the fact that Firstgas had taken a view on some matters that had been subject to ongoing industry debate.

1.4.2 Matters for Gas Industry Co to consider

The independent assessor noted the following matters where Gas Industry Co's perspective would assist an assessment of the reasonableness of the Agreement:

1. Prudential requirements
2. Liability in relation to non-specification gas
3. Disconnection
4. Limitations on liability and liability caps
5. Use of information

The independent assessor noted that substantive retailer feedback on the Agreement was limited, and we did not have the benefit of detailed discussion of these matters. However, we have provided some observations to support the independent assessor's report and future industry discussions.

Prudential requirements

The independent assessor queried, but did not offer a view on, whether the prudential requirements in the Agreement are reasonably balanced. In particular, whether the allocation of risk is appropriate, noting that this may not necessarily be the same as settlement risk in the electricity market.

We have reviewed the prudential arrangements in the electricity Default Distributor Agreement (DDA). These are set at two weeks of distribution services charges, with a process for additional security of up to two months of distribution services charges. The starting point in the Agreement is two months of distribution services charges. Presumably this timeframe allows for non-payment of a monthly invoice for distribution charges as well as allowing for the event of default process.

It is not obvious to us that prudential requirements in the Agreement are unreasonable, although we have not undertaken a detailed assessment. The main concern with prudential arrangements is the potential for a high level of security to provide a barrier to new participants entering the gas retail market. We are not aware of any concerns being raised by current or prospective gas retailers and expect that current gas retailers will have no difficulty with the current security requirements, or they will rely on an acceptable credit rating instead of being required to provide security. We also note that there are currently very few small gas retailers and we are not aware of anything to suggest that this situation is likely to change in the near future. This is, however, a matter that could be revisited, but not one that we believe requires consideration at this time.

Non-specification gas

The independent assessor queried who should have liability in relation to non-specification gas as the Agreement does not provide retailers with a remedy. This is likely to be a concern for gas retailers as they have responsibility for ensuring that gas supplied to consumers is of a specification that is suitable and safe for use under the Gas (Safety and Measurement) Regulations 2010 and is of an acceptable quality under the Consumer Guarantees Act 1993.

Currently, gas is injected at transmission system level, not at distribution system level. This may change in the future with the introduction of renewable gases, a matter that is provided for in the Agreement. Gas specification is primarily determined by the operation of gas treatment facilities prior to injection into the gas transmission system. Generally, gas treatment is under the control of gas producers. Once gas enters the transmission system, it mixes with gas from other sources and may be impacted from dust in the transmission system or oil from compressor stations (although filters are designed to remove these contaminants). Gas producers are the party with the most control of the specification of gas that enters the gas transmission system and subsequently flows into distribution networks. While contaminants such as dust can be introduced at a distribution network level, other contaminants are very unlikely due to the absence of compressors, the use of polyethylene pipes and the lower pressure.

As previously mentioned, at a legislative level, the party selling gas (the retailer) is responsible for compliance with the gas specification. However, as discussed above, that party is generally not able to physically impact gas quality, and nor is the distribution network owner (although the Agreement does assign liability to Firstgas in the unlikely event that the actions of Firstgas, as a distributor, cause gas to become non-specification gas).

The Maui Pipeline Operating Code (MPOC) requires direct injecting parties (gas producers) to indemnify Firstgas for any losses incurred as a result of non-specification gas injections. Firstgas indemnifies welded parties interconnected to the Maui Pipeline. Under the Gas Transmission Code (GTC), Firstgas indemnifies shippers for loss arising from, or in relation to, that Shipper taking non-specification gas at a delivery point (subject to specific liability limits and caps). Currently all gas retailers are shippers and would have the benefit of the indemnities under the GTC.

It seems to us that liability for non-specification gas is covered under the gas transmission codes. This means that, although retailers may not have a remedy under the Agreement, they may have a remedy as a shipper under the GTC.

We note that the assessment did not take into account other documents or industry arrangements. While, on the face of it, there may appear to be a gap by not addressing liability in relation to non-specification gas in the Agreement, remedies in relation to non-specification gas are addressed in the gas transmission codes. We would suggest that including a separate set of liability arrangements in relation to non-specification gas events in the Agreement may have the effect of altering the allocation of risk that currently exists in the gas transmission codes.

Disconnection

The independent assessor noted that issues around disconnection had been raised in previous assessments. Although no further concerns were raised, the independent assessor suggested that Gas Industry Co confirm that the correct balance has been achieved in relation to disconnection of ICPs.

Historical concerns largely focused on the burden of network charges for vacant properties. Retailers argue that, in the case of vacant premises, they no longer have a customer to bill and therefore should not be liable for network charges that they cannot pass on. Distributors considered that retailers should still be liable for network charges as there is still an active connection.

Industry seems to have arrived at pragmatic solution. Retailers are liable for lines charges in relation to vacant properties. However, when retailers change an ICP's status to inactive on the gas registry, liability for network charges ceases. Retailers will consider the likelihood of gas being used at the property and decide whether it is worthwhile continuing to incur lines charges, or if disconnection makes sense.

Limitations on liability and liability caps

The independent assessor noted that there are differing views on the reasonableness of limitations on liability, and the liability caps in the agreement appear to be reasonably arbitrary.

Most of the limitations on liability align closely with the electricity DDA with the exception of some risks that are unique to gas (e.g. certain exclusions in relation to non-specification gas).

The liability caps in the Agreement also align closely with the liability caps in electricity DDA, with a slightly higher cap for direct physical damage to individual consumers with higher consumption. Firstgas has accommodated the size of retailers to some extent by having a separate liability cap that is based on a retailer's share of distribution network charges for any liability other than direct physical damage at consumer premises.

Whether the potential liability exposure is materially different for electricity and gas could be debated at length. When the Electricity Authority consulted on the DDA, concerns included whether a standard cap of \$2 million is appropriate given the size and number of participants on a particular network and the implications this has for liability exposure. The Electricity Authority did not provide a lengthy discussion, instead pointing out the diversity of approaches across electricity distributors. The cap in the Agreement, based on a retailer's share of distribution network charges, appears to be an attempt to address this concern.

Use of information

Principle 13 provides that use-of-system agreements should only require the provision of information for the purpose of enabling efficient and effective gas distribution. The independent assessor noted that the Agreement allows Firstgas to require retailers to provide customer information that is necessary to fulfil its obligations under the Agreement as well as development of pricing methodologies, price categories and network management. The independent assessor noted that the lack of a reference to efficient and effective gas distribution prevented full alignment, but suggested that this principle could be reframed as no parties raised concerns with this aspect of the Agreement.

In our view, the purposes for which Firstgas can require retailers to provide information are not obviously outside the scope of enabling efficient and effective gas distribution. The principle may benefit from specific examples rather than a wholesale reframing.

Principle 14 provides that confidential and non-confidential information should only be used for the purpose for which it was provided. The Agreement restricts the use of confidential information, but does not restrict the use of non-confidential information. The Agreement provides that consumption data is only confidential information to the extent that it relates to an individual user or an ICP. Aggregated customer information is therefore not confidential

and there are no restrictions on Firstgas's use of aggregated data. This concerns some retailers who consider that Firstgas could use this information to its commercial advantage. Access to, and the scope to use, information has been an issue between electricity distributors and retailers for some time and it seems that this issue has extended to gas use-of-system agreements. It appears the Agreement is less restrictive than the equivalent electricity arrangements, although there is probably less scope for Firstgas to derive commercial benefit from aggregated consumer data than there is in electricity.

Our view is that the principle is appropriate, and it would be a relatively minor amendment to the Agreement to achieve full alignment and address retailer concerns.

1.5 Next steps

We will follow-up with retailers regarding progress on signing the Agreement, noting that Pulse Energy was the only retailer to have signed the Agreement when the assessment report was completed.

We will also be contacting distributors to understand what changes, if any, they intend to make to their use-of-system agreements now that there is visibility of the Agreement and the independent assessor's assessment against the Scheme principles.

In our view, use-of-system agreements should be revisited from time-to-time to ensure that they align with industry practices and standards. For example, the Agreement includes new concepts relating to decarbonisation of gas distribution networks (such as the injection of renewable gases). We expect that distribution network owners will consider ongoing development of their use-of-system agreements including incentivising, and removing, barriers to the uptake of renewable gases.